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C O N F I D E N T I A L SECTION 01 OF 05 COLOMBO 000154

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DEPARTMENT FOR D, SA, SA/INS; NSC FOR E. MILLARD

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SUBJECT: February Co-Chairs Meeting: Where We Go From Here

Refs: Colombo 150, and previous

(U) Classified by Ambassador Jeffrey J. Lunstead.
Reasons 1.5 (b,d).

1. (C) SUMMARY: The USG-hosted February 17 Tokyo co-chairs meeting in Washington comes at an appropriate time. Cohabitation between the President and the Prime Minister remains highly stressful which unfortunately means that a possible return to the peace table has been pushed down the road. The delay in talks means that assistance, explicitly linked to progress in the peace process in the Tokyo Declaration last year, has not proceeded apace. Lost in the shuffle is the fact that the peace process (as opposed to the peace talks) is progressing. The incremental but significant progress in the process must be encouraged and nourished and not allowed to wither because of the cobwebs on the peace table. The co-chairs meeting in Washington can play a key role in supporting the ongoing peace process by underscoring the need for donors to increase the pace of donor assistance on an island-wide basis. At the same time there should be a clear message that the assistance spigot will not be turned all the way on until there is substantial progress at the peace table.

2. (C) For Department principals involved in the February 17 meeting, this message provides an in-depth analysis of the political and economic situation in Sri Lanka, as well as options in the assistance area. Mission has also included a draft statement to be issued by the co-chairs after the February 17 meeting, which is contained in Para 20 and is for Department's review.
END SUMMARY.

Co-chairs Meeting Crucial Opportunity

3. (C) The USG-hosted February 17 Tokyo co-chairs meeting in Washington comes at an appropriate time. Cohabitation between the President and the Prime Minister remains tense which unfortunately means that a return to the peace table appears distant at this point. Moreover, the SLFP-JVP electoral alliance inked on January 20 in our view increases the chances of nationwide elections (historically bloody, vehement affairs in this country). The outcome of those elections could well make it even more difficult for peace talks to resume.

4. (C) The delay in the peace talks (nothing has taken place since the Tigers walked away in April 2003, although they produced their "counterproposal" for an interim governing authority in October) means that assistance, especially in the North and the East, explicitly linked to progress in the peace process in the Tokyo Declaration last year, has not proceeded apace. While significant donor activity is taking place throughout the country, the LTTE continues to beat the drum that assistance is inadequate and that it is unfair to punish the North and the East for the South's inability to get its political act together (this argument conveniently glosses over the fact that the Tigers left the table first, not the GSL, and stayed away for six months).

5. (C) Lost in the shuffle is the fact that the peace process (as opposed to the peace talks) is progressing. Each month that the ceasefire continues to hold means that peace, not war, becomes the norm and makes it more difficult for either side to go back to the battlefield. Each month, displaced Tamils return to their homes. Houses are being built and communities re-established. Local peace committees try to defuse conflicts and promote reconciliation. Humanitarian demining is moving forward. This incremental but significant progress must be encouraged and nourished and not allowed to wither because of the cobwebs on the peace table.

6. (C) It is imperative, therefore, that the co-chairs

meeting in Washington hammer out a way to support the ongoing peace process. This includes increasing the pace of donor assistance to the North and the East while ensuring that sufficient aid will continue to flow to the "South" to reinforce the Prime Minister's message that the peace process will bring prosperity to the entire island, not just to the Tamil areas. At the same time there should be a clear message that the assistance spigot will not be turned all the way on until there is substantial progress at the peace table.

Political Outlook

17. (C) In the political arena, the situation in the South remains very troubling. Since Sri Lanka's cohabitation experiment began in December 2001, the relationship between President Kumaratunga and Prime Minister Wickremesinghe has been dysfunctional -- and relations have only plunged to new depths after the President's takeover of three key ministries (Defense, Interior, Mass Communications) on November 4. In response, the PM demanded that all three portfolios be returned to government control immediately. From mid-November until mid-December, a joint committee composed of representatives of both leaders met to try to resolve the situation, but it had little success in ending the impasse. Further complicating matters, the PM made an unexpected announcement in early January that the government could no longer take responsibility for the February 2002 ceasefire agreement with the Tamil Tigers in light of the President's continuing control of the Defense Ministry.

18. (C) The downward spiral of action and reaction has continued in recent days. For example, a dispute has arisen as to the exact length of President Kumaratunga's term in office. While it was widely assumed that her second term would end in late 2005, the President has publicly stated that she believes that she is entitled to serve until late 2006. The PM and his supporters have indicated that they will contest this. In addition, as touched on above, the recent signing of an alliance between the President's SLFP party with the anti-peace process JVP has led to fears that Sri Lanka's political class is girding itself for general elections. Given current temperatures, such elections could be violent beyond all precedent. Even if parliamentary elections are not called, Provincial Council elections are slated to take place in April sparking similar fears about violence and thuggery. An overarching issue to all the infighting is President Kumaratunga's strongly held view that she will not be treated by the PM for the next two (or three years) of her term in the same poor way she feels she has been treated in the past two years, i.e., cut out of the decision-making loop. In the meantime, while the peace process on the ground continues and even moves forward in some areas, there are gathering signs that the Tamil Tigers are growing concerned by the uncertain situation in the South.

19. (C) Amid all the bad vibrations, one piece of good news is that the two sides still appear willing to discuss their differences. After a month's hiatus, the joint "Mano-Malik" committee is meeting again. It is the case that the President and PM have agreed on roughly 80 percent of the issues necessary for a compromise, but the two remain hung up on the last 20 percent. The basic question is which Defense Ministry powers should be given back to the PM, and which kept in the President's hands. As the two sides meet, a factor favoring compromise is that both sides appear receptive to some extent to the views of the international community, especially India and the U.S. As bad as things are, they could well be worse if not for Secretary Powell's recent letters to the two principals,

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or Indian government discussions with Kumaratunga on the margins of the recent Islamabad SAARC Summit. In light of this, we believe that the President and PM will carefully listen to the message emerging from the upcoming Washington co-chairs meeting and factor it into their subsequent actions on the political stage.

Economic Forecast

10. (C) Meanwhile, the cohabitation crisis and impending drought make the economic forecast tepid at best. There are three economic realities donors need to face. The current (post-November 4) economic situation is not going to lift Sri Lanka's overall standard of living in any meaningful way. Delivering aid to the

north-east and deep south could keep the economic base from deteriorating further and give non-combatants in the area a taste of a peace dividend, encouraging further support of the peace process. Finally, real, sustained economic growth is not possible until political stability is realized, a return to peace negotiations takes place, and major infrastructure projects get underway.

11. (C) The ongoing political impasse has led some foreign investment to stay on the sidelines, awaiting a resolution. Further, progress on investment projects already in the country has been slowed as GSL decision-makers are distracted by current events. On the macro-front, it appears that an ongoing drought will have a negative effect on the agriculture and power sectors and reduced foreign investment is pushing the rupee down against the dollar. The IMF process is off-track, with a likely return to Article IV consultations that eliminate an expected USD 80 million loan tranche this year. World Bank (and perhaps also Japanese) budgetary assistance will almost certainly be delayed. There are some silver linings though -- tourism continues to boom, remittances remain strong and the service sector continues to be the engine of growth. The main garment manufacturers are developing a strategic plan for post-2005 and intend to double output over the next decade.

12. (C) Moving forward on assistance to the north-east will have a positive effect in answering some LTTE concerns about the political squabble and help residents in the north-east recognize additional economic benefits from the peace process. Further, it will have the important psychological effect of showing that donors are not letting the political infighting in Colombo deter them from the long-term goal of securing a peaceful settlement that allows Sri Lanka to prosper economically.

13. (C) Real, sustained economic growth, however, will be elusive until major infrastructure and reintegration programs and projects are brought online. Clearly such an undertaking needs all parties to be back at the negotiating table at least. Therefore, continued political bickering in the south that keeps the parties away from negotiations continues to doom Sri Lanka to the realm of mediocre economic growth potential.

Assistance Issues

14. (C) The best method for ensuring that key development funding is not completely hamstrung by the lack of progress at the peace table (while not opening the floodgates) would be to work in those areas where a clear humanitarian need is evident. The returns for these efforts should be high impact, visible, and directly attributable to assistance that flows as a result of the peace process. All donors agree that despite the continued impasse between the President and Prime Minister and the stalled peace talks, the people of Sri Lanka need to continue to see the benefits of peace -- particularly outside Colombo.

15. (C) Mechanisms exist for the continuation of "peace dividend" projects which focus on communities affected by the conflict island-wide. These include World Bank and Asian Development Bank programs that fund community infrastructure and humanitarian assistance activities which provide these benefits. Some bilateral donors are contributing to these projects. Bilateral donors are also providing funding to NGOs and contractors to address some of the needs of targeted communities and vulnerable groups, including food, humanitarian assistance and human security. These funds, pledged as part of the Tokyo aid package, need to keep flowing and be accelerated. Possibilities also exist for funding through the North East Reconstruction Fund (NERF) to which several donors have already pledged support. Negotiations with the LTTE on how the GSL and LTTE can jointly review and submit projects for NERF funding should continue. If the NERF itself cannot be resuscitated, given its historical baggage, then a "NERF-like" mechanism may need to be created to do the job. The project can be used to meet the immediate needs of the people in the North and East.

16. (C) There appears to be donor agreement that humanitarian assistance, demining and small scale community based projects (schools, clinics, roads needed for access to services, water, sanitation, housing for returnees, resettlement activities) and other activities that promote the participation of people in decision making on areas that affect their daily lives should continue and be accelerated. Work should be done using

local structures to the extent possible.

17. (C) Projects which may be held back from the \$4.5 billion dollar pledge for leverage should be those which are desired by both parties (information and communication technology, for example) or other development big ticket items which are not critical to meet basic social and humanitarian needs of the people. The "stick" should be seen as having leverage equally on both parties, not just one. The "carrot" should be for the on-the-ground priorities that affect the well-being of people and communities.

18. (C) In the gray area are meta-infrastructure projects which should be viewed through the lens of how they are facilitative of meeting basic human needs including creating greater opportunities to enhance livelihoods. Meta projects should be those vital to restore connections such as access to markets, schools, health facilities, etc., at the local level. Donors should continue to talk to one another and review big-ticket items especially ones involving large new construction.

19. (C) This tack allows for a positive trend in economic growth to continue while holding the carrot of larger-scale, major growth-inducing projects for all to see on the horizon.

Suggested Post-Meeting Statement

20. (C) The public optics of the co-chairs meeting will be key. We suggest that the four co-chairs release a press statement at the end of the February 17 event along the following lines:

Begin text:

(opening pleasantries, etc.) . . . and are pleased to note that the ceasefire in Sri Lanka has held for two years. With each passing month of peace, more displaced Sri Lankans continue to return to their homes, more humanitarian demining occurs, and daily life in previously contested areas becomes progressively more settled and bearable. The co-chairs applaud these indicators of peace, while at the same time calling for the earliest possible resumption of the peace talks which have been suspended since April 2003. Progress at the peace table is essential if the encouraging progress in the peace process is to be sustained.

In the same vein, the co-chairs note that the political "cohabitation crisis" in the South between the President and the Prime Minister poses the greatest impediment to an early return to the peace table. The tense situation in the south is also harming prospects for economic investment and growth. The co-chairs call on all political figures in Sri Lanka to find a method to establish clarity of responsibilities, so that the peace negotiations -- and the entire process of governance -- can resume.

The co-chairs note that in the absence of peace negotiations support for the peace process throughout the country becomes even more important. They call on all donors to find appropriate mechanisms through which adequate amounts of humanitarian relief and assistance to improve the quality of life at the community level can continue to be delivered to all needy areas of the country. At the same time, the co-chairs wish to draw attention to the specific language in the Tokyo accords which makes clear that full release of aid funds pledged at the Tokyo conference cannot go forward in the absence of substantive progress at the peace table.

End text.

21. (U) Minimize considered.

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